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THE WHITE HOUSE

WASHINGTON

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June 24, 1970

MEMORANDUM FOR

SENIOR ADMINISTRATION OFFICIALS

SUBJECT: Revenue Sharing

This Administration came to office at a time when many Americans were frustrated (often justifiably) with the performance of existing governmental institutions. We have, therefore, proposed basic changes in the domestic policies of the Federal Government. The Administration's new domestic policies, taken together, constitute a strong effort to reform major program systems, renew our federalism, and strengthen the capacity of governmental institutions -- at the national, State and local levels.

Last August, I submitted to the Congress a proposal for sharing a portion of Federal revenues with State and local governments. This innovative program is designed to extend Federal assistance to these governments in a broader, fairer, and less conditional manner.

Over the years this mechanism will have a substantial economic and political effect on our Federal system.

The arguments in favor of revenue sharing are as strong as ever:

1. We have a serious "fiscal mismatch." The Federal government has the superior revenue-generating system. The other levels of government have the major domestic expenditure requirements. The Federal government has long recognized this discontinuity between public needs and resources. So far, we have chosen to bridge the gap through the mechanism of categorical grants-in-aid to State and local governments. Next year, nearly $28 billion will be spread over 500 separate and uncoordinated aid categories.

2. We need to design better systems for delivering Federal program assistance and better methods of fiscal assistance. Revenue sharing represents a valuable and necessary supplement to our existing financial assistance efforts. Increased resources and additional decision-making responsibility will be transferred to States and localities. Local discretion and flexibility will be encouraged. Citizen discontent over the inability of the Federal government to deliver services effectively provides strong incentive to decentralize some governmental decision-making.

3. The revenue capacity of State and local government is severely strained -- despite their considerable efforts. During the 1960s, the States made over 300 increases in major taxes, either enacting new taxes or raising rates on existing ones. Property taxes are very high in many areas. These governments need financial help. The simplest, most direct, and fairest way to provide that help is through revenue sharing.

4. Adequate provision of basic public services is a matter of high national priority. Revenue sharing is directly responsive to this need. We look to our States and localities to provide these services, and revenue sharing funds represent vital support for our domestic programs.

5. Americans not only are frustrated with the performance of governmental institutions, but also with the unresponsiveness of these institutions to local concerns. The individual citizen can have the largest impact on public policy through his State and local governments. By strengthening these governments, revenue sharing can enhance individual contributions to public decision-making. Through revenue sharing an important measure of political power is returned to the people.

I want to emphasize the importance of revenue sharing in our total domestic policy. Revenue sharing is the financial heart of the New Federalism.

Under the New Federalism, major aims are to define more clearly functional responsibilities among levels of government and strengthen governmental institutions at all levels. Welfare, for example, is appropriately a national responsibility. In addition to providing equity and dignity for the poor, the Family Assistance Act will relieve State and local governments of rapidly rising costs for welfare.

In areas which are primarily State-local responsibilities, revenue sharing and other measures which the Administration has advanced will strengthen the capacity of States and localities to make decisions which reflect their own priorities and needs.

In the first full year of the Family Assistance Program, fiscal relief for states and localities will be nearly $600 million, in addition to the currently estimated revenue sharing program of $1 billion.

I encourage all of you to become familiar with the basic elements of the Administration's revenue sharing proposal and to make known, at every suitable occasion, our strong desire to secure its enactment in 1970. A very brief description of revenue sharing, along with major questions and answers, is enclosed.

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SUMMARY OF THE ADMINISTRATION REVENUE-SHARING PLAN

The leading features of the Administration's revenue-sharing proposal are as follows:

-- First, the total amount to be shared will be a stated percentage of personal taxable income -- the base on which Federal individual income taxes are levied. The fund will grow fairly rapidly from a currently projected program of $1 billion on a full-year basis to reach $5 billion by the mid-'70's.

-- Second, the distribution of the fund among the states will be based on a simple formula that assigns primary weight to population, but also gives some weight to tax effort exerted in the State.

-- Third, the distribution within each State between the State government and the localities will be based on a formula, so that each unit of general government within a State will be assured a share that is proportionate to its own revenues raised.

-- Fourth, no program or project restrictions will be placed on the use of the funds made available by the Federal Government. Each State, county, city and town will rely on its own judgment, and allocate the funds as it deems best.

The distinguishing characteristics of this proposal are:

(1) Simplicity -- objective statistics and clearly defined procedures are used;

(2) Fairness -- all general purpose local governments participate, regardless of size;

(3) Dependability -- State and local governments can count on the funds in their planning; and,

(4) Discretion -- State and local governments are free to use the funds wherever they determine the need most pressing.

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QUESTIONS AND ANSWERS ON
THE ADMINISTRATION'S REVENUE-SHARING PROPOSAL

1. Q. What is the purpose of this proposed legislation?

   A. The ultimate purposes are:

   -- to restore to the States their proper rights and roles in the Federal system with a new emphasis on local initiative and discretion;

   -- to provide both the encouragement and the necessary resources for local and State officials to exercise leadership in solving their own problems;

   -- to restore strength and vigor to local and State governments;

   -- to achieve a better allocation of total public resources.

2. Q. Why do State and local governments need revenue sharing?

   A. One reason is due to what President Nixon calls the "fiscal mismatch." Federal tax receipts, based largely on incomes, tend to grow faster than the economy. At the local level, the reverse is true. State and local revenues, based heavily on sales and property taxes, do not keep pace with economic growth, while expenditure requirements for education, health, welfare, and other local services tend to exceed such growth.

3. Q. <u>But doesn't the Federal Government provide aid to State and local governments already?</u>

A. Yes. Federal grants to State and local governments will amount to $24 billion during fiscal year 1970 and an estimated $28 billion in 1971. But this assistance is being distributed through a confusing array of nearly 500 separate program authorizations. A basic objective of revenue sharing is to supplement the existing Federal aid effort with broader and less conditional fiscal assistance. In this manner, both funds and the responsibility for their proper allocation will be transferred to the States and localities.

4. Q. <u>But if some "surplus" revenue develops at the Federal level, why not reduce the Federal tax take -- leaving the field open for States and localities?</u>

A. This is not a matter of sending back to the States "excess" Federal revenues left over from Federal program requirements. Revenue sharing should be viewed as an <u>expenditure</u> for a basic national purpose -- strengthening the financial base of our Federal system of government. It should be evaluated with other expenditure programs and assured delivery to State and local governments.

5. Q. <u>How much money is to be shared?</u>

A. The size of the total fund to be shared will be a stated percentage of personal taxable income -- the base on which Federal individual income taxes are levied. To provide for an orderly phase-in of this program, the FY 1971 percentage will involve new obligational authority of $275 million for the last quarter of the year -- or $1 billion on a full-year basis; subsequent fiscal year percentages will be increased annually up to a permanent one percent for fiscal year 1976 and thereafter. On this basis, we estimate an appropriation for fiscal 1976 of about $5 billion.

6. Q. <u>The initial amount of revenue sharing does not sound like much, particularly when it is split up among 50 States and thousands of cities and counties. Wouldn't this just be a drop in the bucket for most communities?</u>

A. Given the current and near-term budget outlook, we realistically faced two alternatives for introducing revenue sharing: (1) either delay introducing the plan until funds are available to begin a full-scale program, or (2) establish the plan now and provide for phased increases as budget resources permit. The second course of action is clearly preferable. With all the competing claims for limited Federal revenues, it is important to establish the principle of revenue sharing as soon as practicable.

7. Q. <u>Can the States and localities depend on this flow of funds to be regularly appropriated?</u>

A. In order to provide for the assured flow of Federal funds, a permanent and indefinite appropriation will be authorized and established for the Department of the Treasury, from which money will be automatically disbursed each fiscal year, as required by the revenue sharing act.

8. Q. <u>How will the funds be distributed?</u>

A. The funds will be distributed from the Federal Treasury to the 50 States and the District of Columbia. Each State will receive an amount based on its share of national population, adjusted for the State's revenue effort. The revenue effort factor provides the States with some incentive to maintain (and even expand) their efforts to use their own tax resources to meet their needs. Revenue effort is the ratio of total general revenues collected by State and local governments in a given year to the total personal income of that State.

9. Q. <u>Will the States be required to share some of this distribution with their local governments?</u>

A. Yes. The allocation of a State's share among its general units of local government will be established by prescribed formula. The proportion which an individual local government will receive corresponds to the ratio of its own revenues to total State and local government revenues in the State.

10. Q. <u>Why are these particular distribution formulas used?</u>

A. Distributions based on revenues raised have several important advantages:

-- they make allowance for State-by-State variations in preferences;

-- they tend to be neutral with respect to the current relative fiscal importance of State and local governments in each State;

-- they provide a method for allocation among government units with overlapping jurisdictions.

11. Q. <u>By sharing revenues with every city, county, and town, is the effectiveness of this plan diluted too much?</u>

A. We are unable to find an acceptable or logical point at which revenue sharing funds should be denied a local government. Some proposals would exclude all cities and counties of less than 50,000. All local governments are faced with fiscal pressures, often especially acute for small communities, and all deserve specific inclusion in the revenue-sharing program.

12. Q. What restrictions or qualifications will be imposed on the use of these funds?

A. There will be no program or project restrictions on the use of these funds. One purpose of revenue sharing is to permit local authorities the programming flexibility to make their own budget allocation decisions. Each State will be required to meet minimum reporting and accounting requirements.

13. Q. Are State and local governments able to establish proper social priorities for the allocation of their revenue sharing funds?

A. The answer can be obtained by examining the pattern of State and local spending. From their own revenue, they have consistently spent the lion's share on education, health and hospitals, and public welfare.

14. Q. How do the various State, county, city and other local officials view this revenue-sharing proposal?

A. We have had numerous discussions with governors, mayors, and county officials on this proposal. There has developed a remarkable degree of approval. Revenue sharing has now been enthusiastically backed by the national associations of governors, mayors, county commissioners, and other State and local leaders.

15. Q. How much of a new administrative apparatus will be required to administer revenue sharing?

A. None. The plan has been designed to operate almost automatically, avoiding any requirement for the establishment of any new Federal bureau or agency. The whole purpose is to avoid Federal controls and to increase the fiscal discretion available to State and local governments.